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EX PARTE OR LATE FILED

EX PARTE PRESENTATION

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

RECEIVED

JAN 23 1998

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

Re: *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket No. 96-149*

Dear Ms. Salas:

On January 9 and January 12, 1998, Sprint Communications Company L.P. and AT&T, respectively submitted ex parte presentations concerning the regulatory classification of the long distance affiliate of SBC Communications Inc. in light of the U.S. District Court for the Northern District of Texas's December 31, 1997 decision in SBC Communications Inc. v. FCC, Civil Action No. 7-97CV-163-X. Pursuant to Section 1.1206(a)(1) of the Commission's Rules, 47 C.F.R. § 1.1206(a)(1), SBC hereby submits the attached memorandum, which briefly addresses Sprint's and AT&T's arguments.

As discussed in detail in the attached memorandum, despite Sprint's and AT&T's claims to the contrary, SBC's long distance affiliate has been found to be and is classified as a non-dominant interexchange carrier under the Commission's regulations and the District Court's decision in SBC Communications Inc. invalidating the Act's "Special Provisions" has no effect upon and does not change that classification.

In accordance with the Commission's Rules, an original and two copies are provided herewith. Please contact me should you have any questions.

Very truly yours,

Todd F. Silbergeld

Attachment

cc: Ms. C. Matthey
Mr. C. Brown

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MEMORANDUM

In recent *ex parte* filings, AT&T and Sprint urge the FCC to resurrect the Telecommunications Act of 1996's "Special Provisions Concerning Bell Operating Companies" struck down in *SBC Communications, Inc. v. FCC*¹ ("*SBC v. FCC*") or to erect new entry barriers or conditions uniquely applicable to Bell Operating Company ("BOC") affiliates' provision of in-region, interstate, interexchange services.² The Commission has already rejected AT&T's and Sprint's efforts to hobble new competition, for good and substantial reasons that remain valid and compelling notwithstanding the decision in *SBC v. FCC*.

It is ironic that two of the four largest interexchange carriers are attempting to persuade the Commission to impose dominant carrier regulation on new entrants. The Commission has already found, in the *Second Report and Order* in CC Docket No. 96-149, that the lack of nationwide facilities-based networks will put BOC interLATA affiliates at a disadvantage relative to those incumbent carriers, particularly because the cost of resold services will generally exceed the marginal cost of providing those services.³ AT&T and Sprint now seek to compound their advantage by convincing the

¹ *SBC Communications v. FCC*, Civ. Action No. 7-97CV-163-X, slip op. (N.D. Tex. Dec. 31, 1997).

² Letter from Betsy J. Brady, Vice President, Federal Government Affairs, AT&T Corp., to Magalie Roman Salas, Secretary, FCC, dated January 12, 1998, ("AT&T Memo"); Letter from Thomas Jones, Counsel for Sprint Communications Company L.P., to Magalie Roman Salas, Secretary, FCC, dated January 9, 1998 ("Sprint Memo").

³ *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61*, FCC 97-142, at para. 97 (rel. April 18, 1997) (hereinafter *Second Report and Order*).

Commission to impose “dominant carrier” regulation on their new BOC-affiliated competitors, while they remain subject to non-dominant carrier treatment.

Both AT&T and Sprint make numerous arguments to support their claim that any BOC affiliate that seeks to provide interLATA services under the authority of *SBC v. FCC* would be subject to FCC regulation as a dominant carrier. Sprint also argues that the FCC can use Section 214 or Section 251(g) to resurrect the line-of-business restrictions of the Modification of Final Judgment.⁴ All of those arguments are without merit, as demonstrated below.

I. BOC INTERLATA CARRIER AFFILIATES ARE NON-DOMINANT

The Commission, in the *Second Report and Order*, held unequivocally that BOC affiliates offering in-region, interstate, interexchange services cannot exercise market power and are, therefore, non-dominant.⁵ It did so on the basis of the following fundamental principle:

[A] BOC interLATA affiliate should be classified as dominant only if we find that it has the ability profitably to raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting its own output.⁶

The Commission found that a BOC interLATA affiliate could not exercise market power in the in-region, interstate, interexchange market by restricting its own output. Indeed, with no market share at entry, the only way a BOC interLATA affiliate could even theoretically restrict its own output and thereby gain the power to control prices in

⁴ *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff’d. sub. nom. Maryland v. United States*, 450 U.S. 1001 (1983).

⁵ *Second Report and Order* at paragraph 6.

⁶ *Id.*

that market would be to seek to control interconnection or access prices or to cross-subsidize entry, to such an extent that it could then drive all other competitors out of the market and then raise prices and restrict output. The FCC recognized the impossibility of such occurrence in its “substitutability” analysis in the *Second Report and Order*. The Commission there found that:

As to supply substitutability, we note that the Commission has previously found that the excess capacity of AT&T’s competitors is sufficient to constrain AT&T’s exercise of market power. In light of that finding, we conclude that AT&T and its competitors, which currently serve all interLATA customers, should be able to expand their capacity sufficiently to attract a BOC interLATA affiliate’s customers if the affiliate attempts to raise its interLATA prices. ... The existence of such demand substitutability supports the conclusion that the BOC interLATA affiliates will not have the ability to raise prices by restricting their output. Finally, given the presence of existing interexchange carriers, including such large well established carriers as AT&T, MCI, Sprint, and LDDS, we find that the cost structure, size, and resources of the BOC interLATA affiliates are not likely to enable them to raise prices above the competitive level for their domestic interLATA services.⁷

As the U.S. Supreme Court observed in the *Matsushita* case, “[P]redatory pricing schemes are rarely tried, and even more rarely successful.”⁸

In any event, BOCs cannot exercise market power by controlling interconnection or access prices because the FCC and/or state regulatory commissions regulate the prices, terms and conditions of interconnection and access service. The effect of that regulation is to preclude the types of activities by the BOC that could enable the affiliate to exercise market power. In the *Second Report and Order*, the Commission agreed with the Department of Justice that applying dominant carrier regulation to an affiliate in a

⁷ *Id.* at para. 97 (footnotes omitted).

⁸ *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

downstream market would be “at best a clumsy tool for controlling vertical leveraging of market power by the parent, if the parent can be directly regulated instead.”⁹

The Commission has already established, in the *Fifth Report and Order* in the Competitive Carrier Proceeding,¹⁰ its ability to regulate the BOC directly through its imposition of equal access requirements and the structural separation requirements on LECs, in addition to the Commission’s access charge rules, imputation requirements, cost allocation, and affiliate transaction rules. The equal access requirement of Section 251(g) is still in place and is still effective in preventing any unlawful discrimination or price squeeze, all of which become of less concern as the FCC moves toward cost-based access service rates.¹¹ Since all of those requirements apply equally to the BOCs, the FCC found no rational basis for concluding that dominant carrier regulation, which was rejected for the independent LECs, would be any more suitable for the accomplishment of the same regulatory goals for a BOC affiliate.

Even if the Commission were to decide to open a new proceeding to consider the regulatory requirements after *SBC v. FCC*,¹² the application of different separation requirements for BOC and other LEC long distance affiliates (as set forth in Part 64,

⁹ *Second Report and Order* at para. 91 (emphasis added).

¹⁰ *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Fifth Report and Order*, CC Docket No. 79-252, 98 FCC2d 1191 (1984).

¹¹ *Second Report and Order* at para. 171.

¹² Contrary to AT&T’s and Sprint’s implications, there can be no “automatic” determination of dominance. The Commission’s Rules define “dominant carrier” as “[a] carrier found by the Commission to have market power (i.e., power to control prices).” 47 C.F.R. § 61.3 (o). The Commission has never made such a finding with respect to the BOC interLATA affiliates. To the contrary, the Commission unequivocally held that BOC affiliates offering interLATA services cannot exercise market power and are, therefore, non-dominant. See *Second Report and Order* at para. 6. Thus, as AT&T seems to acknowledge, a full notice-and-comment rulemaking would be required to alter the regulatory status of BOC affiliates. See AT&T Memo at 6.

Subpart Q of the Commission's Rules) would violate the "symmetry" principle recently established by the Commission in the context of separated affiliates for LEC commercial mobile radio services ("CMRS"). There, the Commission (citing an SBC pleading) ruled that LEC wireless affiliates should be subject to the same separation rules, regardless of BOC or non-BOC affiliation:

As the *Cincinnati Bell* court observed, the disparate treatment imposed on the BOCs affects their ability to compete in the ever-evolving wireless communications market. In this respect, we agree with commenters that have argued that any rules we establish today promote regulatory symmetry, and that any costs imposed should apply to all CMRS providers.¹³

The FCC did refer to the separation requirements identified in Section 272 as one component in its analysis of the central market power issue in the *Second Report and Order*, but it also relied heavily upon other regulatory and factual constraints that would operate to prevent BOCs from exercising market power.¹⁴ These factors, all of which remain in place, include the presence of four major long distance competitors,¹⁵ price cap regulations,¹⁶ the availability of a variety of antitrust and Communications Act enforcement mechanisms,¹⁷ and other provisions of the 1996 Act.¹⁸

¹³ *Local Exchange Carrier Provision of Commercial Mobile Radio Services*, 12 FCC Rcd 15668, 15696 (rel. October 3, 1997).

¹⁴ In any event, by its terms, paragraph 134 of that decision predicates the non-dominance finding on compliance with Section 272 and the implementing regulations, not their mere existence. Accordingly, reclassification of BOC affiliates as dominant carriers would have to be based on a specific Commission finding of non-compliance, after appropriate adjudication. This argument is strengthened by the FCC's statement in the preceding paragraph that it "retain[ed] the ability to impose some or all of the dominant carrier regulations on one or more of the BOC interLATA affiliates if this proves necessary in the future." *Id.* at para. 133. Thus, non-dominant status will be removed only if there is specific evidence of market power or non-compliance with the Commission's rules.

It is clear that the *Second Report and Order* requires structural separation for BOC interexchange affiliates, as it did for independent LEC interexchange affiliates. It is the degree of separation resulting from the structure required by Section 272, not the applicability of Section 272 itself, that is relevant for the market power analysis. It appears that those structural separation requirements were considered in the portion of the order relating to BOC affiliate entry because those requirements were expected to be applicable to the BOC affiliates at entry; if those requirements had not been in place at that time, then presumably, the Commission would have simply made its own determination as to the degree of structural separation that would be required, as it did with the ILECs. In any event, so long as the structural, transactional, and nondiscrimination requirements discussed with regard to the BOC interLATA affiliates in the *Second Report and Order* are, in fact, met, it would be arbitrary and capricious for the Commission to readdress the same question and reach a different result.

The Commission also emphasized the favorable impact of non-dominant BOC affiliates on consumer choice, pricing, and new product offering and questioned the need for, and efficacy of, burdensome dominant carrier regulation.¹⁹ Thus, it is clear that imposition of dominant carrier regulation on the BOC interLATA affiliates would not be appropriate, even in the absence of Section 272; it is far more reasonable to apply the same or similar structural separation requirements for BOC interLATA affiliates, as are required of the independent LECs.

¹⁷ *Id.* at para. 128.

¹⁸ *Id.* at para. 126 (i.e., unbundled network elements).

The Commission's findings in the *Second Report and Order* and similar proceedings make clear that no newly emerging BOC interexchange affiliate operating with the degree of separation set out in Section 272 (or Part 64, Subpart Q) could ever meet the test previously established by the FCC for dominant carrier treatment.

II. SECTION 214 WAS NOT DESIGNED TO ADDRESS POTENTIAL PROBLEMS OF BOC ENTRY INTO COMPETITIVE MARKETS

Sprint urges the Commission, to declare BOC affiliates offering in-region, interLATA services as dominant carriers, and then to use its Section 214 processes as a means of resurrecting portions of the invalidated Special Provisions. Section 214 is not suited to that purpose. As noted by the Commission in the *Second Report and Order*, even AT&T has agreed that Section 214 requirements were not designed to address the potential problems associated with BOC entry into competitive markets.²⁰ In its *Second Report and Order*, the Commission stated that:

[W]e question whether more stringent section 214 requirements would be an efficient means of addressing the concerns raised by BOC entry. Congress enacted the facilities-authorization requirements in section 214 and subsequent amendments primarily to prevent investment in unnecessary new plant by rate-base regulated common carriers and to bar service discontinuance in areas served by a single carrier. [footnote omitted] Because we previously have found that markets for long distance services are substantially competitive in most areas, marketplace forces should effectively deter carriers that face competition from engaging in the practices that Congress sought to address through the section 214 requirements.²¹

¹⁹ *Id.* at paras. 86-134.

²⁰ *Second Report and Order* at para. 86, citing AT&T Comments, CC Docket No. 96-149 at 19 (filed Aug. 15, 1996) (dominant carrier regulation would not address any of the concerns raised in the Notice); USTA Reply, CC Docket No. 96-149 at 23-24 (filed Aug. 30, 1996).

²¹ *Second Report and Order* at para. 86.

The congressional intent underlying Section 214 has not changed; thus, no change in the manner in which that statutory provision is applied can be justified as the result of the *SBC v. FCC* decision.

While the judicial order striking down the Special Provisions is in effect, the FCC is bound by it. If the Commission were, at the behest of two of the four largest interexchange carriers, to engage in extraordinary manipulations of its normal regulatory processes in an apparent attempt to avoid that decision, serious questions would be raised about the propriety and legality of its actions. Besides, questions of compliance with a valid order of a federal court, the kind of “results-oriented manipulation” of regulatory precedent that AT&T and Sprint urge as a means of indirectly achieving an ulterior objective would be arbitrary and capricious.²² Moreover, the summary reimposition of disparate regulatory burdens on the BOCs, which could in no way be justified by record facts, would be unlawful.²³

III. SECTION 251(g) DOES NOT PRESERVE THE MFJ’S LINE-OF-BUSINESS RESTRICTIONS

Sprint contends that Section 251(g) preserves, *sub silentio* and by operation of law, the “line-of-business restrictions along with all other MFJ provisions governing the relationships between the exchange and interexchange activities of the BOCs.”²⁴ The plain language of Section 251(g) however, clearly demonstrates that this provision was intended to preserve pre-existing equal access and nondiscriminatory interconnection

²² See *Public Serv. Comm’n v. FERC*, 813 F.2d 448, 464-465 (D.C. Cir. 1987).

²³ See *Cincinnati Bell*, 89 F.3d at 768 (demanding a “reasoned explanation” why the BOCs, but not other telephone companies, must conduct cellular operations through a separate affiliate).

²⁴ Sprint Memo at 4.

rules (including access charges), and neither expressly nor implicitly addresses the line-of-business restrictions:

On and after the date of enactment of the Telecommunications Act of 1996, each local exchange carrier ... shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment. During the period beginning on such date of enactment and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.²⁵

Sprint itself appears to recognize that this provision applies only to “equal access and nondiscriminatory interconnection restrictions and obligations.”²⁶ Nonetheless, Sprint states that:

“the reference to the restrictions and obligations ‘under any court order [or] consent decree’ plainly incorporates, among other things, the provisions of Section II of the Modification of Final Judgment, the section entitled ‘BOC Requirements’ ... This section contains the equal access, nondiscrimination, and line-of-business restrictions of the Decree.”²⁷

Clearly, however, the statutory reference to restrictions and obligations in consent decrees is limited to those restrictions and obligations identified earlier in the same sentence: equal access and nondiscriminatory interconnection restrictions and obligations applicable to the provision of exchange access.

²⁵ 47 U.S.C. § 251(g).

²⁶ Sprint Memo at 3.

²⁷ *Id.*

As Sprint has conceded, Section II of the MFJ contains three categories of restrictions: those relating to equal access, nondiscrimination, and lines-of-business.²⁸ Only the first two are covered by Section 251(g), as the language of that provision makes abundantly clear.²⁹ Where Congress expressly identifies certain matters as included within a statutory provision and fails to identify others, the omission is presumed intentional.³⁰

Sprint's position is also contradicted by the legislative history of Section 251(g), which was added to the 1996 Act by the Joint Conference Committee as part of the Staff Draft dated December 13, 1995. The Joint Explanatory Statement further confirms that this provision was intended to cover only equal access and non-discriminatory interconnection and does not incorporate the line-of-business restrictions:

The approach of both the Senate bill and the House amendment assumed that Bell Operating Companies ("BOCs") would be required to continue to provide equal access and nondiscrimination to interexchange carriers and information service providers under those parts of the AT&T Consent Decree that would have remained in effect under either approach. Because the new approach completely eliminates the prospective effect of the AT&T Consent Decree, some provision is necessary to keep these requirements in place

²⁸ *Id.*

²⁹ Contrary to Sprint's claim, the Commission's assertion of authority under Section 251(g) to define LATA boundaries in no way confirms that this part of the statute incorporates the line-of-business restrictions. Sprint Memo at 3, citing *U S WEST Petitions to Consolidate LATAs in Minnesota and Arizona*, 12 FCC Rcd 4738 (1997) (*U S WEST LATA Order*). That decision stands only for the proposition that FCC control over LATA boundaries "is an essential component of the Commission's authority to enforce the equal access and interconnection restrictions established under the AT&T Consent Decree." *Id.* at 4748. While SBC does not necessarily agree with the Commission's analysis, it is clear that the *U S WEST LATA Order*, by its very terms, rests only on the equal access and nondiscriminatory interconnection obligations of the MFJ, and does not support Sprint's expansive reading of Section 251(g) as including the line-of-business restrictions.

³⁰ See, e.g., *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 168 (1993).

Accordingly, the conference agreement includes a new section 251(g). This section provides that, on and after the date of enactment, each local exchange carrier . . . shall have a statutory duty to provide equal access and nondiscrimination to interexchange carriers and information service providers.³¹

The infirmity of Sprint's Section 251(g) argument is further evidenced by the structure of the 1996 Act. Congress imposed the line-of-business restrictions on the BOCs through the Special Provisions (and particularly, Sections 271 and 273 through 275), as Sprint essentially concedes.³² It is, thus, nonsensical to suggest that the MFJ's line-of-business restrictions were also implicitly included in Section 251(g).

IV. CONCLUSION

The arguments raised by AT&T and Sprint in their recent *ex parte* filings are nothing more than an effort to delay the introduction of effective long distance competition. The BOCs' long distance affiliates do not have any market power and have been classified as non-dominant carriers, as the Commission unequivocally declared in the *Second Report and Order*. Further, Section 214 is not the appropriate regulatory tool for regulating BOC entry, as the Commission has previously recognized. Finally, Section 251(g) does not, and cannot, in any way grant the FCC jurisdiction to enforce the MFJ's line-of-business restrictions.

³¹ Joint Explanatory Statement at 9 (emphasis added).

³² See Sprint Memo at 2 ("Of course, the so-called 'special provisions' of Title II, the sections under attack by SBC, largely grew out of the MFJ.").